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UNCLAS SECTION 01 OF 03 TAIPEI 001152

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USDOC FOR 4420/USFCS/OCEA/EAP/LDROKER
USDOC FOR 3132/USFCS/OIO/EAP/ADAVENPORT
TREASURY FOR OASIA/MOGHTADER
TREASURY PLEASE PASS TO OCC/AMCMAHON
TREASURY ALSO PASS TO FEDERAL RESERVE/BOARD OF
GOVERNORS, AND SAN FRANCISCO FRB/TERESA CURRAN

E.O. 12958: N/A
TAGS: EINV EFIN ECON TW
SUBJECT: Taiwan's 2004 Balance of Payments

REF: Taipei 875

SUMMARY

¶1. In 2004 Taiwan's balance of payments (BOP) posted a surplus of US$26.6 billion, resulting from its trade surplus, earnings from foreign exchange reserves, and capital inflows prompted by continued Taiwan Dollar (NTD) appreciation against the USD. The stronger NTD appears to be cutting into Taiwan's trade surplus. END SUMMARY.

Surplus Builds Foreign Exchange Reserves

¶2. Taiwan recorded a BOP surplus of US$26.6 billion in 2004, the seventh consecutive annual surplus. The BOP surplus and revaluation of reserve currencies against the USD drove Taiwan's foreign exchange reserves up 17% to US$241.7 billion, the third highest after Japan's US$844.5 billion and China's US$609.9 billion. Taiwan's Central Bank (CBC) says about one-quarter of Taiwan's foreign exchange reserves are denominated in non-U.S. currencies. Appreciation of these currencies in 2004 was 8.1% for the EURO, 4.3% for the Japanese Yen, and 1.1% for the Pound Sterling.

Foreign Exchange Reserve Composition Unchanged
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¶4. On February 23, Taiwan's Commercial Times newspaper reported that the Central Banks of Taiwan and South Korea had dumped USD assets, contributing to rapid depreciation of the USD. Taiwan's CBC quickly denied the report. George Chou, Director General of the CBC's Foreign Exchange Department, told AIT/T that the composition of Taiwan's foreign exchange reserves had remained basically unchanged over the past two years (reftel).

Components of 2004 BOP Surplus

¶5. Taiwan's BOP surplus for 2004 totaled US$26.6 billion of which 71.5% came from the current account (C/A) surplus and 23.9% from the financial account (F/A) surplus. Net errors and omissions made up the rest. Taiwan has had a C/A surplus every year over the past five decades except for the oil-shock years of 1974, 1975 and 1980. Taiwan's C/A surplus of US$19.0 billion in 2004 resulted from a trade surplus of US$16.5 billion and net factor income (income residents receive from abroad less similar payments made to non-residents) of US$11.5 billion. These surpluses offset a service trade deficit of US$5 billion and a current transfer deficit of US$3.9 billion. In 2004, merchandise exports and merchandise imports equaled 57% and 55% of GDP, respectively. Taiwan's Capital Account deficit of US$77 million in 2004 has declined steadily from US$287 million in 2000, reflecting a drop in net capital transferred out of Taiwan by residents emigrating overseas.

Major Sources of Imports: USA and Japan

¶6. Only nine percent of Taiwan's total imports are consumer goods, while over 90% are production inputs such as raw materials, intermediary goods, and machinery and equipment. The United States and Japan are the two major sources of Taiwan's imports and provide most of the required manufacturing technologies. In 2004, 13% of Taiwan's total imports came from the United States and 26% from Japan.

Exports from China

¶7. Although China surpassed the United States as Taiwan's largest export market in 2001, the United States is still a major export destination. Taiwan's exports to China are mainly inputs to be processed for re-export to the United States. Business firms take orders in Taiwan and ship products to foreign buyers from China. Export orders coming from the United States account for the largest share (nearly 30%) of total foreign orders received by Taiwan in 2004, higher than the 16% of Taiwan's exports shipped directly to the United States. In 2004, the United States and Greater China (China plus Hong Kong) accounted for over half of Taiwan's total exports.

Factor Income

¶8. Taiwan's 2004 earnings of US$10.9 billion on its foreign exchange reserves constituted 96% of total Factor Income (payments residents receive from abroad for land, entrepreneurship, labor, and capital) surplus last year. The CBC earned an overall 4.5% rate of return for Taiwan's foreign exchange reserves in 2004. Inflows to Taiwan from dividends and profits distributed by overseas branches or subsidiaries of Taiwan companies in 2004 for the first time exceeded outflows from foreign firms in Taiwan. Taiwan's services trade deficit was down from US$9 billion in 1995 to US$5 billion in 2004.

Capital Supplier to the World

¶9. Despite Taiwan's Financial Account surplus of US$6.4 billion in 2004, which indicates a large net capital inflow, Taiwan remained a major capital supplier to other countries. Outbound portfolio investment in 2004 amounted to US$23.5 billion, 38% more than the US$17 billion of inbound portfolio investment. Taiwan's direct investment overseas in 2004 totaled US$7.1 billion; nearly quadruple the US$1.9 billion in foreign direct investment in Taiwan. Outward direct investment has exceeded inward direct investment every year since 1987 when Taiwan first permitted investment in China. Taiwan's cumulative overseas investment approved by the Ministry of Economic Affairs through December 2004 totaled US$83.3 billion, half of which went to China. A significant part of the non-China investment went to China via Hong Kong, the United States, and tax havens such as Bermuda, The Cayman Islands and The British Virgin Islands. The CBC estimates Taiwan's investment in China exceeds US$70 billion.

Capital Inflow by Speculators

¶10. The 2004 Financial Account surplus of US$6.4 billion resulted mainly from capital inflows by speculators expecting continued appreciation of the NTD. CBC Economic Research Department senior specialist Chen Yu-shiu told AIT/T that in the second half of 2004, the NT dollar (NTD) appreciated 6.7% against the USD, much higher than would be expected just from the interest rate gap between USD and NTD deposits. Foreigners deposited US$10 billion with Taiwan banks last year. Some foreign portfolio investors parked investment funds in bank accounts in expectations of foreign exchange gains, according to Chen.

Prospects

¶11. Taiwan's C/A surplus has strengthened the NTD, and the stronger NTD has led to changes in the pattern of Taiwan's foreign trade. The NTD's 10% appreciation against the USD since mid-2004 has helped reduce Taiwan's trade surplus from US$4.7 billion in Q3 of 2003 to US$2.4 billion in Q3 of 2004, down to a trade deficit of US$0.2 billion appeared in Q4 of 2004. Taiwan's trade surplus in the first two months of 2005 dropped 51% from the same period a year ago. Local economists think that in the longer term, Taiwan will continue to post a trade surplus and C/A surplus, although smaller than in 2003 and 2004 and that the strong NTD will continue to attract foreign capital, unless cross-Strait relations deteriorate significantly.

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